No. 11,941

IN THE

United States Court of Appeals

For the Ninth Circuit

HARRY V. SOANES,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

FRANK O. BELL,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

LUTHER E. GIBSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

VALLEJO BUS COMPANY (a dissolved California corporation),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' REPLY BRIEF.

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Subject Index

Table of Authorities Cited

Cases

Text Books

Statutes Pages

General Laws of the State of California

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PETITIONERS' REPLY BRIEF.

I.

IN HIS FIRST ARGUMENT RESPONDENT ATTEMPTS TO SHOW THAT THE PARTIES INTENDED THE BUS LINES AND FRANCHISES TO REMAIN THE PROPERTY OF TAXPAYER CORPORATION UNTIL APPROVAL WAS OBTAINED FROM THE RAILROAD COMMISSION.

This contention, of course, completely overlooks the clear statement in the document executed on June 9, 1942, that the sale and transfer is effective on June 1, 1942 *except* in the event that approval of the Railroad Commission is *not* forthcoming.

In this connection respondent first examines the petition filed with the Railroad Commission and certain of the recitals contained therein. However, the purpose of the petition was to bring to the notice of the Railroad Commission the transaction contained in the agreement of sale and to request an order authorizing this transfer. Consequently, regardless of what was said in the *recitals* in the petition, the *substance of the transaction was contained in the agreement of sale attached to the petition.* The transaction for which the Commission's authorization was requested was for a sale of the operative assets and franchises of the petitioner, and as noted in the written agreement, "the sale of said personal property herein above described *shall be effective as of June 1, 1942.*" (R. 27, italics added.) This is the sale the Commission was asked to authorize and this is the sale the Commission did authorize.

Respondent then notes that the relief requested in the petition to the Railroad Commission was not to "*ratify* a transfer already completed, but for an 'order authorizing the transfer'." (Br. 12.) Respondent concludes from

this that the transfer referred to in the petition could not therefore be completed prior to the Railroad Commission's order. True the petition to the Railroad Commission asked for an "order authorizing the transfer", but the transfer referred to is the one contained in the exhibit to the petition, which transfer was plainly stated to be "effective as of June 1, 1942". Again, this is the sale the Commission was asked to authorize and this is the sale the Commission did authorize.

Respondent next notes that the Railroad Commission's order authorizing the sale contained certain conditions, but an examination of the Railroad Commission's order indicates that it is not merely a single order authorizing the sale *subject* to certain conditions but is a group of four orders (R. 33, 34). In its first order the Commission authorized the transfers of the properties in question; second, the Commission ordered the partnership to file a time schedule; third the Commission ordered the partnership to file a copy of their articles of partnership; and fourth, the Commission set the effective date of its order. It is respectfully called to the Court's attention that the order authorizing the transfer is not made dependent upon compliance with the other three orders.

Respondent in passing notes that the partnership's articles were not reduced to writing until November 12, 1942 (Br. 13) and from this infers that the partnership arrangement prior to this date was merely of a tentative character. This, however, is an irrelevant consideration since the Civil Code of California does not require written articles of partnership and since the respondent and petitioner have stipulated (R. 16) that the articles of

partnership drawn up on November 12, 1942 merely reduced to writing the *prior understanding* of the partners. Consequently, no change in the partnership itself was effected by reducing the articles to writing and no inference may therefore be drawn that the partnership was any less durable prior to the reduction of the articles to writing than it was after. Because of the foregoing, petitioner respectfully requests that respondent's inference in this regard be disregarded.

Respondent next examines the agreement of sale itself which was drawn up on June 9, 1942 (Br. 13-16). By examining some, but not all, of the provisions of this document respondent concludes that it speaks only in the future. His explanation of the flat statement that the sale will be "effective as of June 1, 1942" is that this was a mere attempt to pass title retroactively (Br. 15). It should be noted, however, that the offer and acceptance resulting in a valid and binding contract of sale was executed on May 19, 1942; this is set out at length in Exhibit 2 (R. 23-25). In this underlying transaction it is stated: "said sale to become effective on the 1st day of June, 1942, subject to the approval of said transfer by the Railroad Commission of the State of California" (R. 24). This offer and acceptance created a valid contract of sale on May 19, 1942 and there is nothing retroactive in the passage of title on June 1, 1942 since that date is obviously *subsequent* to the date on which the contract of sale was made. The provisions of the document drawn up on June 9, 1942 are in all material respects the same as the offer and acceptance completed on May 19, 1942. Cf. Exhibit 2 and Exhibit 3 (R. 23-28). This document restates that

June 1, 1942 is the effective date of the sale and *clarifies the intention of the parties* concerning the approval of the Railroad Commission by stating that the sale will be effective on June 1, 1942 *except* "in the event said approval is *not* forthcoming, * * *" (R. 27, italics added). It is apparent from this condition that the parties clearly intended the sale to be effective on June 1, 1942, and remain effective unless defeated by the express condition subsequent, to-wit, that the approval does *not* forthcome. Furthermore, the parties carried out this intent by their actions. A few examples of such actions are: The opening of the bank account by the partnership in its own name on June 1, 1942 (R. 17); the depositing of all revenues and receipts from the bus lines in the partnership's bank account (R. 17); and the endorsing of all of petitioner's insurance policies over to the partners and the partnership (R. 17). Moreover, since the parties owning the petitioner were identical with the partners composing the partnership, the transfer was merely a change in the bus line's form of business organization and hence there was no reason whatsoever to anticipate that the approval of the Commission would not be forthcoming in due course. Since the document was dated June 9, 1942 and since the effective date was June 1, 1942, and since the parties had taken the various steps indicated above, it seems certain that as of the date of the document the parties understood that the sale was already effective and was to remain effective except upon the remote contingency that the Railroad Commission would refuse to approve the transfer from the corporate to the partnership form of business. The remoteness of the possibility

of the Railroad Commission's refusing to approve the transfer is even more apparent when it is considered that the financial ability to respond to damages would necessarily be greater under the partnership form to the obvious benefit of the public.

Returning to the document of June 9, 1942, it should be noted that by this date the consideration in the sum of $29,937.20 had been paid to the seller and in this document the receipt of this sum is acknowledged. Furthermore, in this document the property sold is described in detail and with particularity, including "all franchises and operating rights of the said Seller" (R. 26, 27). The description of the property is followed by the following sentence:

> "*To Have and to Hold* the same [i. e. the described property] unto said Buyers for the sum of Twenty Nine Thousand Nine Hundred Thirty Seven and 20/100 ($29,937.20) Dollars, in lawful money of the United States of America, receipt of which is hereby acknowledged by the said Seller." (Italics added.)

It is petitioner's contention that despite the executory phraseology of the first part of this document (R. 26), the habendum clause quoted above, plus the fact that *the entire consideration had been paid,* makes it clear that this document must be interpreted as a *bill of sale* transferring title to the described property from the seller to the buyers on June 1, 1942. It follows that not only did the parties intend to transfer the bus line properties and franchises immediately without waiting for approval of the Railroad Commission but that they actually accomplished the transfer of title by this bill of sale.

It is clear, therefore, for the reasons set out in petitioner's opening brief (pp. 20-24) and for the additional reasons set out herein that respondent's piecemeal examination of the various documents produces a clearly erroneous conclusion as to the intention of the parties as to the effective date of the sale and transfer in question.

Moreover, the interpretation which the Railroad Commission placed upon the agreement of sale, the petition, its order authorizing the sale, and the transaction *in its entirety* is made plain from its opinion in the rate case, *In re Vallejo Bus Co.,* 44 C.R.C. 627 (1943). In this proceeding it was necessary for the Railroad Commission to determine the actual date of transfer of the properties from the corporation to the partnership since the amount of income taxes allowed as a deduction from operating revenues could not otherwise be ascertained and since the fares which the Commission would permit the bus lines to charge were directly dependent upon its net operating revenues, past, present, and prospective. The Railroad Commission, therefore, had to consider the intention of the parties in their agreement of sale, the intention of the parties in their petition to the Railroad Commission concerning the transfer and sale, and the effect of the Commission's order issued in response to that petition. In the rate case public hearings were held (R. 35), a report was prepared by the Commission's Transportation Research Engineer (an expert) (R. 35), the partnership was represented by attorneys, the city of Vallejo was represented by an attorney, Petaluma subdivision was represented by an attorney, the Vallejo Chamber of Commerce was represented by an attorney, and certain other tax-

payers were represented by an attorney (R. 35). The finding of fact reached by the Commission after public hearings, an expert's report and the arguments of numerous attorneys was that "The company operated as a corporation until June 1, 1942, *after which time it becomes a partnership*" (R. 37, italics added). For the reasons set forth above, this is not an immaterial finding of fact since this was one of the factors upon which the ultimate rate reached was directly dependent. This finding of fact of the Railroad Commission in an adversary proceeding clearly indicates what the Commission thought was the intention of the parties as to the effective date of the sale and what the Commission thought were the material portions of the petition, the contract of sale, and its own order concerning the effective date of sale. This opinion of the Railroad Commission in the rate case is, therefore, most material and helpful in resolving any superficial ambiguities which may appear from a piecemeal consideration of the documents in question.

Respondent in passing (Br. 14) notes that it has been stipulated (R. 17) that record legal title of the automobiles as evidenced by ownership certificates were not surrendered to the state authorities for transfer from the corporation to the partnership and that it was not until new ownership certificates were issued in the succeeding year that record legal title was thus transferred. Respondent cites this as material in showing that the parties did not intend to transfer the property in question. It should be noted, however, that the stipulated facts concern only "*record* legal title" and not actual title to the vehicles in question. This fact would appear, therefore, to be im-

material since, as noted by this Court in *Seattle Renton Lumber Company v. United States,* 135 F.2d 989 (1943), the deed, declaration of trust and bill of sale were *not recorded.* Therefore, in the *Seattle Renton* case, "*record* legal title" to the assets remained in the vendor. Nevertheless, as petitioner has pointed out in its opening brief (p. 23), this Court considered that recording the various documents was *not essential* to there being a completed transaction for income tax purposes at the date contended for by the taxpayer therein. Petitioner respectfully submits, therefore, that the mere formality of recording legal title is immaterial in determining the intention of the parties as to the effective date of the Vallejo Bus sale and hence should be disregarded.

Respondent in his brief (pp. 16, 17) suggests that it is not reasonable to imply an intent for a transfer as of June 1, 1942 since the parties' affairs would remain in an *unsettled state* until the Railroad Commission acted and this would be for an indefinite period. This appears to be an unwarranted inference since as it turned out the whole matter was settled in approximately three months and furthermore, as heretofore pointed out, it is unreasonable to presume that the Commission would have refused its approval.

Respondent continues in his brief (p. 17) by stating "a presumption exists against an intention of the parties to a present sale" since the goods were not in a *deliverable condition.* In this regard respondent cites Rule 2 of Section 1739 of the Civil Code of California. These rules help to ascertain when the property in the goods passes to the buyer. If the goods were not in a deliverable condition,

the respondent is correct. However, whether or not goods are in a deliverable condition must be determined by the intention of the parties as to what constitutes a deliverable condition. The recent case of *Woodbine v. Van Horn,* 29 Cal. (2d) 95, 173 P. 2d 17 (1946), concerned the sale of certain eucalyptus wood "to be cut in sixteen and twenty four inch lengths and all wood over five inches in diameter to be split". The Court nevertheless held that there had been a completed sale prior to cutting, and at page 107 noted:

> "* * * Under the terms of the agreement, Van Horn, the seller, had to cut the wood into certain lengths and split some of the wood before the goods would be in a deliverable state. *But this presumption is not conclusive* if there is substantial evidence justifying a determination that the contract is one of sale.
>
> "The conduct of the parties frequently shows whether they regard the bargain as passing the property and the fact that part of the purchase price is paid by the buyer is evidence that the parties contemplate an immediate transference of the property in the goods. * * *" (Italics added.)

Petitioner submits, therefore, that Rule 2 of Section 1739 of the Civil Code of California is not applicable to the facts in the Vallejo Bus transaction since the *entire* purchase price had been paid by June 9, 1942 (R. 27) and the parties had previously executed the sale on June 1, 1942 (although it might later be invalidated if the Commission's authorization was *not* forthcoming). Petitioner submits, therefore, that Rule 3 of Section 1739 of the

Civil Code of California governs the sale in question. Rule 3 reads as follows:

> "(Delivery 'on sale or return.') (1) When goods are delivered to the buyer 'on sale or return,' or on other terms indicating an intention to make a present sale, but to give the buyer an option to return the goods instead of paying the price, the property passes to the buyer on delivery, but he may revest the property in the seller by returning or tendering the goods within the time fixed in the contract, or, if no time has been fixed, within a reasonable time."

Further evidence as to the applicability of Rule 3 is noted in the stipulation of facts (R. 17) wherein insurance policies covering the property in question were endorsed over to the buyers on June 11, 1942. It is apparent that on and after this date the *buyers* considered the *risk of loss for damage to the property or from the use of the property was theirs.* In the treatise 2 Williston on Sales, Revised Edition, Section 273, it is stated:

> "Varying consequences of sale or return and sale on approval.
>
> "The differences in the rights of the parties in the two kinds of agreement under consideration are briefly the differences which always exist between the rights of those having the property and of those having merely a contract for the property. *If the property has passed, the risk of accidental loss or damage rests upon the buyer.* If the property has not passed, the risk still remains with the seller. * * *" (Italics added.)

Petitioner submits, therefore, that the transaction in question is covered by Rule 3 of Section 1739, Civil Code of

California, and the intention to make a present sale must, therefore, be presumed.

Respondent's final argument regarding the intention of the parties as to the effective date of the sale and transfer in question concerns the opinion of the Railroad Commission in the rate case, *In re Vallejo Bus Co.,* supra. Respondent notes in his brief (p. 17) "The only question involved before the Commission in the cited proceeding was the determination of rates; the partnership was then unquestionably the operating owner, and the issue here involved was not at all relevant, was not litigated before it nor presented to it for decision." Petitioner believes that its discussion of *In re Vallejo Bus Co.,* herein, (pp. 7-8) and in its opening brief (pp. 17-19) demonstrates that the issue involved in the present case was clearly relevant and highly material to the determination of the rates in the rate case. At the risk of being repetitious, petitioner, however, wishes to emphasize the importance of this decision to the issue herein. In determining the fair rate to be charged it was necessary for the Railroad Commission to consider the past earnings of the bus lines, the present earnings of the bus lines and prospective earnings of the bus lines. *The past earnings of the bus lines could not be determined without deducting as an expense from gross revenues the amount of income taxes paid to the Federal Government.* If income taxes had been paid in the sum asserted by respondent herein, the bus lines' earnings for the year 1942 would have been materially reduced and would, of course, have materially reduced the rate of return realized by these lines (Cf. Table I, R. 39). Consequently, if the Commission had con-

sidered the corporation to be the owner until September 15, 1942, they may well have fixed a higher rate for fares to be charged during and after the year 1943. Therefore, the actual owner of the properties was *directly in issue* in the rate case and any findings in this regard by the Commission may *not* "be regarded as inadvertencies completely immaterial to the issue there presented to the Commission for decision" as respondent has characterized them in his brief (p. 23).

Petitioner respectfully asserts, therefore, in answer to respondent's argument concerning the intention of the parties as to the effective date of the transaction in question, that for the reasons set forth herein and in petitioner's opening brief said transaction was clearly *intended by the parties* to be effective as of June 1, 1942. Petitioner concludes, therefore, that the Tax Court's interpretation of the stipulated facts is clearly erroneous and therefore the decision of the Tax Court should be reversed.

II.

IN HIS SECOND ARGUMENT RESPONDENT CONTENDS THAT UNDER THE LAW OF CALIFORNIA THE TRANSFER COULD NOT BE CONSUMMATED UNTIL APPROVAL BY THE RAILROAD COMMISSION HAD BEEN OBTAINED.

In this connection respondent first notes that Section 50⅓ of the Public Utilities Act of California makes a violation of Section 50¼ a misdemeanor and provides for punishment upon conviction thereof. Respondent also notes that Sections 76 and 77 of the Public Utilities Act provide penalties for violations of the Act for offenses

not otherwise provided within the Act. Respondent reasons from this that if the Vallejo Bus transaction had been a completed transfer prior to securing the authority of the Railroad Commission, it would have infringed the criminal and penal provisions of the Public Utilities Act and would have been void for illegality. Petitioner asserts that respondent's conclusion in this regard is wholly unfounded and immaterial to the case at issue and for the reasons set forth below, merely tends to cause confusion.

In the first place, if, as respondent contends (Br. 20), the sale was void until approval was received from the Railroad Commission, the action would be a complete nullity and consequently would constitute no violation of the penal provisions of the Public Utilities Act since they do not punish an *attempted* violation but only an actual violation of the Act. It would follow, therefore, that there could never be a violation of the Public Utilities Act concerning the sales and transfers of a utility's assets until subsequent to a decision of the Commission since, if respondent is sound, any sale prior thereto would be nugatory and void.

In the second place, the inclusion of penal provisions in the Public Utilities Act would seem to indicate that the legislature realized that a sale could be consummated *prior to approval* by the Railroad Commission, that such a sale was not null and void in its inception and might result in a violation of the Public Utilities Act if such sale were not later approved. This is in accordance with petitioner's contention that where a sale has actually been consummated, as in the Vallejo Bus transaction, the action of the Commission concerning such

sale is in reality either a ratification or a veto of that sale.

In concluding his argument concerning the penal provisions of the Public Utilities Act, respondent in his brief (p. 20) states as follows:

> "* * * A consummated transaction, such as taxpayers here assert, falls within the direct prohibition of the statute and upon well settled principles would have been unenforceable and void for illegality. * * *"

Respondent then cites *Napa Valley El. Co. v. Calistoga El. Co.*, 38 Cal. App. 477, 176 Pac. 699 (1918), and refers also to 6 Williston on Contracts (Rev. Ed.), Section 765 [1765], and Restatement, Law of Contracts, Section 580. Respondent's conclusion that a *consummated* transaction is unenforceable and void for illegality does not appear to be supported by either the case or the treatises cited. In the *Napa Valley* case Napa and Calistoga were both public utilities and gave mutual options to each other for the sales of their properties. Napa exercised its option and Calistoga refused to convey. Napa then brought this suit to compel conveyance and the lower Court sustained a demurrer to Napa's complaint because Napa had failed to allege that it had secured an order of the Railroad Commission of California authorizing the sale. Napa refused to amend its complaint and the plaintiff appealed to the District Court of Appeal on this *sole* ground. The District Court of Appeal affirmed the lower Court in upholding defendant's demurrer. Consequently the only question before the District Court of Appeal was one of pleading. Thereafter plaintiff sought to petition to have the cause heard by the Supreme Court of Cali-

fornia, which was denied. However, it is interesting to note that in denying this petition the Supreme Court stated:

> "In denying the application, we deem it proper to say that we do so upon the theory that, in view of the matters stated in the opinion, the equitable remedy of specific performance is not available to the plaintiff. In view of such a conclusion, *it is unnecessary to decide whether the attempted agreement was absolutely void,* and we are not to be understood as expressing any opinion thereon." (Italics added.)

This opinion of the Supreme Court of California shows first that the Supreme Court considered that the case decided *only a question of pleading* and, secondly, that whether or not the contract was absolutely void was an open question in California. Although respondent has cited this case as authority that a *consummated* transaction would have been unenforceable and void for illegality, the case did not concern a consummated transaction but only concerned a point of *pleading* upon a contract of sale *which had not yet been executed.*

Section 1765 of Williston on Contracts (interpreting Section 580 of the Restatement) which the respondent also cites as stating that a *consummated* transaction is unenforceable and void, reads as follows:

> "Statutes prohibiting certain sales or requiring licenses therefor.
>
> "Where a statute *prohibits altogether* the sale of certain goods, not only is the bargain for such sale invalid, but if the sale *is made* in violation of law,

the agreed price cannot be recovered. * * *'' (Italics added.)

It should be noted that Williston considers that the sale *can be made* even though the statute *prohibits it altogether* and the only thing which cannot be enforced is the recovery of the purchase price by the seller. It is apparent, therefore, that the *Napa Valley* case and the treatise are a far cry from the proposition for which they are cited and, as a matter of fact, uphold petitioner's contention that the Vallejo Bus transaction resulted in a sale and transfer effective as of June 1, 1942.

Respondent's second argument (Br. 20) concerning the Public Utilities Act of California attempts to show that the California Courts have repeatedly ruled that prior to authorization by the Commission a purported transfer by a public utility is void and confers no rights upon the purported transferee. In support of this proposition respondent first cites the cases of *Crum v. Mt. Shasta Power Corp.*, 220 Cal. 295, 30 P.2d 30 (1934), and *Slater v. Shell Oil Co.*, 39 Cal. App. (2d) 535, 103 P.2d 1043 (1940). Respondent states (p. 21) that in the *Mt. Shasta* case the Supreme Court of California was ''passing upon the validity of an offer by a public utility to convey its property, where rights *inter sese* of the parties to the attempted transfer were in question, * * *''. An examination of the *Mt. Shasta* case shows that plaintiff was suing defendant on the ground that defendant had interfered with plaintiff's use of certain waters. Plaintiff was required to show actual or prospective damages under the law of California. In the trial

Court the defendant, a public utility, offered a stipulation showing it had agreed to maintain the level of certain waters in Pitville Pool by maintaining a dam there and by causing the discharge into said pool water from the Fall River. All of the water of the Fall River had been dedicated to a public use. The trial Court refused to admit this stipulation into evidence and the only question before the Supreme Court was *whether this evidence was properly excluded.* The Supreme Court affirmed the trial Court on this point on the theory that defendant could not make such a *promise* without first securing the authority of the Railroad Commission. It is apparent, therefore, that there was not a completed transfer of assets as in the Vallejo Bus transaction but only a question of whether or not the admission of a *promise* pertaining to a *future* transfer of assets by a public utility was *properly excluded from evidence* when offered by a defendant to show a lack of actual damage to the plaintiff. The case is plainly *not* authority for any proposition concerning the rights of parties, *inter sese,* to a purported transfer, and hence should be disregarded.

Respondent next cites a dictum from the *Slater* case, supra, which dictum, standing alone, tends to uphold his interpretation of Section 51(a) of the Public Utilities Act. Petitioner respectfully asserts that an examination of the facts of the *Slater* case, supra, will clearly show that it is not in point. Respondent has not set out the *Slater* facts in his brief, so for convenience a summary of these follows herein:

Shell's wholly owned subsidiary pipe line company, a public utility, owned a right of way across Slater's land.

This subsidiary conveyed all its assets to Shell and later was dissolved. Subsequent to the dissolution, Shell constructed a second pipe line over the right of way and Slater sued for damages on the theory that Shell was not the owner of the right of way. The trial Court granted a nonsuit on the sole ground that Shell received the right of way upon the dissolution of its wholly owned subsidiary. The only question before the District Court of Appeal was whether or not the trial Court should have granted the nonsuit. In reversing the trial Court, the District Court of Appeal was only free to rule upon the narrow question of whether or not Shell received the right of way upon the dissolution of its wholly owned subsidiary public utility. This case is clearly not applicable to the Vallejo Bus transaction since the Court was not called upon to decide the rights *as between the parties to the transfer* but was only called upon to protect the interests of the public, one of whom was Slater.

By citing the *Slater* case, supra, respondent reveals his fundamental misconception of Section 51(a) and of the Railroad Commission's powers thereunder. As clearly stated by the Supreme Court of California in *Hanlon v. Eshleman,* 169 Cal. 200, 202; 146 Pac. 656 (1915), and noted in petitioner's opening brief at page 14, *"The Commission's power is to be exercised for the protection of the rights of the public interested in the service, and to that end alone."* (Italics added.) In the Vallejo Bus transaction, however, we are not concerned with "the rights of the public interested in the service" but are interested in the rights of the parties to the transfer.

Respondent (Br. 22) next attempts to refute the doctrine of *Hanlon v. Eshleman,* supra, with a dictum from the case of *Henderson v. Oroville-Wyandotte Irr. Dist.,* 213 Cal. 514, 277 Pac. 487 (1931). Respondent, however, as in the *Slater* case, supra, does not set forth the facts in the *Henderson* case, so for convenience they will be summarized herein. In the *Henderson* case two irrigation companies in 1922 each conveyed a part of their assets to defendant. This sale was approved by the Railroad Commission but certain conditions were imposed as to the areas which had to be served and as to the rates to be charged. The present action was a suit by land owners and water users outside of the exterior boundaries of the defendant for a determination of their rights and duties and those of the defendant in the service of water to the plaintiffs and the rates to be charged therefor. It is obvious, therefore, that the parties litigant are not the vendor and vendee but are the *interested public* as plaintiffs and the vendee as defendant. One of the defendant's defenses was that in specifying conditions as to rates and persons to be served in its order authorizing the sale in 1922 the Commission went beyond its jurisdiction under Section 51(a) of the Public Utilities Act. The dictum cited by respondent herein is in that part of the case which holds that the Railroad Commission was not exceeding its jurisdiction. The dictum cited by respondent (Br. 22) reads as follows:

> "* * * No sale of property burdened with a public use is legal, or of any validity whatever, unless the authority to make such sale is first given by the Railroad Commission. * * *"

Respondent, however, does not cite the sentence immediately following this dictum, which reads as follows:

> "* * * In approving or authorizing such a sale, the Railroad Commission has jurisdiction to impose such conditions as will in the judgment of the Railroad Commission protect and safeguard the pre-existing rights of those entitled to service under said public utility. * * *"

It is obvious from this that the dictum cited by respondent as refuting the *Hanlon v. Eshleman,* supra, doctrine is in effect an affirmance and restatement thereof since the authority to impose conditions is stated to be to "protect and safeguard the pre-existing rights of those entitled to service under said public utility", to-wit, to protect the rights of the public.

Respondent in his brief (p. 22) makes the following statement, the latter part of which appears to be unfounded and contrary to available authority.

> "* * * While the legislature may have vested the power to authorize sales of public utilities in the Commission primarily for the benefit of the public, nevertheless, the better to preserve that function for the Commission, *it plainly prescribed that a sale without first the Commission's authorization is of no validity whatsoever.* * * *" (Italics added.)

The latter proposition stated by respondent (italicized above) is plainly contrary to the statement set forth in 23 Am. Jur., *Franchises,* Section 36, and quoted by petitioner in its opening brief (p. 14), which, for convenience, is repeated herein:

> "* * * Generally, an unauthorized transfer of a public utility franchise is not ipso facto void; *on the contrary, the transfer will be treated ordinarily, as valid and effectual* until attacked by the sovereign grantor in a direct proceeding instituted for the purpose. * * *" (Italics added.)

Moreover, respondent's proposition is also contrary to Section 1765 of Williston on Contracts, cited by respondent in his brief (p. 20) and set forth hereinabove.

Respondent in his brief (p. 22) next considers the case of *Otter Tail Power Co. v. Clark,* 59 N. D. 320, 229 N. W. 915 (1930), relied upon by petitioner in its opening brief (p. 15, et seq.). Regardless of what respondent claims in his brief, the *Otter Tail* case, supra, *actually* held that a completed sale was valid as between the parties thereto, and regardless of any statements of the Supreme Court of North Dakota or of *why* it held this sale to be valid, the important point is that the sale *actually was held to be valid.* As petitioner has noted in its opening brief (p. 15), there appear to be no California cases in which the vendor and vendee have been the parties litigant for a determination of the validity of a completed sale as between themselves. This, however, is the exact point decided by the Supreme Court of North Dakota under a statute which is in all essentials identical with that of the Public Utilities Act of California. Cf. petitioner's opening brief (p. 16) setting forth these statutes. The issue in the *Otter Tail* case, supra, is, therefore, directly in point and the fact that the Court enforced the sale *prior to approval by the Railroad Commission* cannot be sidestepped regardless of the grounds upon which this sale was held valid and enforced.

Respondent's next contention (Br. 23) concerning the validity of the Vallejo Bus transaction under the law of California concerns the finding of fact contained in the rate case, *In re Vallejo Bus Co.*, supra. For the reasons set forth by petitioner hereinabove, petitioner reiterates that the finding of fact by the Railroad Commission, to-wit, that "The company operated as a corporation until June 1, 1942, *after which time it becomes a partnership*" (R. 37, italics added) was material to the issues before the Commission in that case and to the issue before the Court herein.

Petitioner respectfully asserts, therefore, in answer to respondent's argument that under the law of California the transfer could not be consummated until the approval of the Railroad Commission had been obtained, that for the reasons set forth in petitioner's opening brief and hereinabove respondent's conclusion in this regard is clearly erroneous. Petitioner respectfully contends that the decision of the Tax Court of the United States concerning the effect of the transfer under the law of California is likewise clearly erroneous and should therefore be reversed.

III.

IN ANSWER TO PETITIONER'S ADDITIONAL ARGUMENT, RESPONDENT IN HIS BRIEF ADVANCES TWO ARGUMENTS WITH WHICH HE ATTEMPTS TO SHOW THAT THE "CLAIM OF RIGHT" DOCTRINE HAS NO APPLICATION TO THIS PROCEEDING.

Respondent's first argument in answer to petitioner's additional argument, attempts to show that the receipt of income for the period in question by the partnership was

not under a claim of right but was as *agent* of the tax payer corporation.

Respondent begins his agency argument by interjecting into the claim of right doctrine the requirement that the claim of the recipient must be *adverse* to that of another possible claimant (Br. 24). However, it has recently been held that an adverse interest is not necessary in order to bring the claim of right doctrine into operation. In the case of *St. Regis Paper Company v. Higgins,* 157 F.2d 884 (CCA 2, 1946), cert. den. 330 U.S. 843, St. Regis received cash dividends from its wholly owned subsidiary during the years 1936 and 1937. Said dividends were in violation of a trust indenture (the terms of which were known to St. Regis) and upon notice given in 1938 by the trustee of said indenture, said subsidiary rescinded the declaration of said dividends and St. Regis returned them to said subsidiary. Since the subsidiary was wholly owned and controlled by St. Regis, the latter obviously had no adverse interest. Nevertheless St. Regis was held taxable on the dividends for the years 1936 and 1937. In reaching its decision the Court carefully considered the lack of adverse interest and even went so far as to concede that St. Regis could have been held a constructive trustee of the funds. The Court stated:

> "But even though it now be conceded that the appellant could have been charged as a constructive trustee, the claim of right under which it did receive the dividends and hold them as its own until sometime in 1938 is enough to make them income to the trustee for tax purposes in the year of their receipt."

On authority of the *St. Regis* case, petitioner contends that respondent's interjection of an adverse interest into the claim of right doctrine is unfounded.

Respondent, continuing with his first argument, makes the assumption, wholly unsupported by the stipulated facts and exhibits, that the income in question was not received free from restrictions as to its disposition. (Br. 24.) However, an examination of the record reveals that all receipts and revenues on and after June 1, 1942 were deposited in the partnership's own bank account (R. 17) and there is nothing in the record whatsoever to indicate any restrictions upon the funds contained therein. The logical inference which must be drawn from the shifting of the revenues from the taxpayer's bank account to that of the partnership is that the income was received by the partnership on its own account and without restriction as to its disposition. Respondent apparently relies on the fact that under the agreement of sale it was provided that in the remote event approval of the Railroad Commission was not forthcoming, the parties were to return to the same relationship and position as prior to its execution. The mere fact that the income might have to be returned by the partners to the corporation does not alter the fact that the income must be reported as the income of the partners under the doctrine of *North American Oil Consolidated v. Burnet,* 286 U.S. 417 (1932), as pointed out in petitioner's opening brief (p. 25). In this case the Supreme Court specifically stated that the doctrine applied even though the income might later have to be refunded.

Continuing with respondent's first argument, respondent next asserts that possible future criminal liability by the recipients of the income in question must negative any rightful claim (Br. 25). However, as shown by petitioner in its opening brief (pp. 28, 29), this is an irrelevant consideration, and it was so decided in the recent case of *Akers v. Scofield,* 167 F.2d 718 (1948), cert. den. October 11, 1948. In this case Akers, who obtained money by false pretenses and was *previously convicted* of this crime, was nevertheless held to have received the money under a claim of right sufficient to require the funds being taxed to him. See also *Jacobs v. Hoey,* 136 F.2d 954 (1943), cited in petitioner's opening brief at page 27.

Further evidence to indicate that the Tax Court was clearly in error in holding that the partnership was acting as an agent of the taxpayer herein is to be found in the stipulated fact (R. 17):

> "Said partnership opened a bank account on June 1, 1942, in the name of Vallejo Bus Co., a partnership, and all receipts and revenues from the operation of said business on and after that date were deposited in said bank account."

Such an account opened by a partnership whose stated purpose was the operation of bus lines for its own account wholly negatives any idea that the receipt of the funds was as an agent. Moreover, Article 5 of the stipulation reads as follows:

> "On or about June 11, 1942, endorsements were requested with respect to all policies of insurance issued to petitioner naming as assured on said policies Luther E. Gibson, Harry V. Soanes and Frank

O. Bell, doing business as Vallejo Bus Co. Said endorsements were made by the insurers and were effective on or before June 11, 1942." (R. 17).

These endorsements clearly indicate that the partnership was conscious that it was operating the assets on its own behalf and *at its own risk* and consequently the partnership itself wanted the protection of insurance to indemnify it in case of accident. Furthermore, the change of the insured from the taxpayer to the partnership indicates that the partnership was conscious it was not operating the assets for the benefit of the petitioner corporation nor is it reasonable to suppose that the petitioner corporation believed that it was having assets operated on its behalf for which it might be held completely liable without the protection of insurance.

For all of the foregoing reasons taxpayer respectfully asserts that it was clearly erroneous for the Tax Court to conclude that possession by the partnership of the proceeds during the period in question was by the partnership as agent of the taxpayer corporation which remained their lawful owner until September 15, 1942.

Respondent's second argument, in answer to petitioner's additional argument, is based upon an erroneous notion that the claim of right doctrine is merely a handy tool to prevent tax evasion and hence can be used only by the government. Respondent first states that the claim of right doctrine when used as a defense "begs the question" (Br. 25) under the assumption that the taxation of the earnings must follow the ownership of the property. Respondent thus argues that if the corporation was the owner of the earnings from June 1 to September 15, 1942,

it must pay taxes upon them irrespective of the fact that the partners would have income which they would be "required to return" for income taxation under the doctrine of the *North American Oil* case, supra. This argument is obviously fallacious since if it were sound, the earnings for this period would be taxable to both the corporation and to the partners. This argument of the respondent fails to recognize the fact that the claim of right doctrine is an *exception* to the general rule that taxable income follows ownership of the property producing such income. This the petitioner has made clear in its opening brief (p. 25) in its discussion of the *North American Oil* case, supra. As established by that case, the claim of right doctrine is a rule to determine to whom income must be taxed *regardless of the actual ownership of the property producing the income.* To emphasize this point, the words of the Supreme Court in the *North American Oil* case, supra, are repeated herein:

> "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is *required to return,* even though it may still be claimed that he is not entitled to retain the money, and *even though he may still be adjudged liable to restore its equivalent.*" (Italics added).

The words "required to return" leave no doubt that the Supreme Court intended this doctrine of taxable income to be mandatory; hence, if taxpayer A is *required to return* certain earnings, taxpayer B is not. On whom the incidence of tax is to fall is of as much concern to taxpayers as it is to the government. Therefore, petitioner cannot be denied the use of a fundamental concept to show that

the income from the bus lines *must be taxed* to the partnership and not to the petitioner. An analogous situation was presented in the recent case of *Ross v. Commissioner*, 169 F.2d 483, July 13, 1948, in which the Commissioner sought to ignore the doctrine of constructive receipt when invoked by a taxpayer as a defense. Justice Frankfurter, who sat with the First Circuit and wrote the opinion, dismissed this argument of the Commissioner as follows:

> "However, in this circuit at least, it seems settled that the doctrine of constructive receipt can be asserted by a taxpayer to defeat an attempt to assert a tax in a later year. * * * *If this is so, the doctrine does not merely afford a special choice which the Commissioner may, if he sees fit, exercise retroactively against a taxpayer, but a rule of law, determining what constitutes taxable income, and as such presumably binding on all parties.* * * *" (Italics added).

As noted above in the *North American Oil* case, supra, the claim of right doctrine determines what income a recipient is "required to return" and consequently the doctrine is as fundamental a doctrine of income tax law as is the doctrine of constructive receipt. In reliance on the rationale of the *Ross* case, supra, taxpayer asserts that it may not be precluded from the use of the doctrine as a defense.

Respondent closes his second argument, in answer to petitioner's additional argument, by asserting that if the claim of right doctrine can be used as a defense "the Treasury would be at the mercy of parties who might readily arrange between themselves as to which should claim the right and bear the burden of tax." (Br. 26). Respondent then cites a group of cases involving the

assignment of income, family partnerships, and a purported sale by shareholders of corporate assets. The results reached in these cases are ample proof that the Treasury is not at the mercy of the taxpayer. The claim of right doctrine used as a defense is no more open to abuse than the constructive receipt doctrine likewise used as a defense. Cf. *Ross v. Commissioner,* supra.

CONCLUSION.

Petitioner respectfully asserts that respondent has failed to refute petitioner's conclusions set forth at pages 29-30 of petitioner's opening brief. Hence, as established by petitioner's opening and reply briefs, the revenues from the bus lines on and after June 1, 1942, were taxable income of the partnership under section 22(a) of the Internal Revenue Code and were not taxable income of the petitioner, and the decision of the Tax Court of the United States was clearly erroneous in holding otherwise. Therefore, petitioner respectfully submits that the decision of the Tax Court of the United States should be reversed.

Dated, San Francisco, California,
November 4, 1948.

Respectfully submitted,
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